

ST 01-11

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

"DAVID DUKES", as Resp. Officer. of
"The Daisy Dukes Company",

Taxpayer

No. 96-ST-0000
NPL: 0000

RECOMMENDATION FOR DISPOSITION

Appearances: Marc Muchin and George Foster, Special Assistant Attorney Generals for the Illinois Department of Revenue; Mr. Francis J. Emmons of Schwartz & Freeman on behalf of "David Dukes".

SYNOPSIS:

This matter comes on for hearing pursuant to "David Dukes" ("taxpayer") timely protest of a Notice of Penalty Liability No. 0000 issued by the Department of Revenue ("Department") on November 4, 1994 for unpaid corporate sales tax. The Notice was issued to the taxpayer as a responsible officer of the "Daisy Dukes Company" for failure to remit sales tax for the months of April through July of 1992 and September of 1992. The Department conceded at hearing that taxpayer was not liable during September 1992. The issues to be resolved are 1) whether the taxpayer was a responsible officer of the

"Daisy Dukes Company" and 2) whether the taxpayer's failure to file and pay the sales tax due was willful. Upon consideration of the evidence, it is my recommendation that the Notice of Penalty should be finalized.

FINDINGS OF FACT:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Notice of Penalty Liability ("NPL"), issued on November 4, 1994 for April through July of 1992 and September of 1992. Tr. pp. 21, 22; Dept. Ex. No. 1.
2. The NPL issued to "David Dukes" includes "A," "B" and "G" assessments which are issued as a result of: the sales tax return being filed late, a delinquency on a signed return received, and unsigned returns received without full remittance or on estimated returns prepared by the Department, respectively. Dept. Ex. No. 1.
3. In October of 1992, "David Dukes" was terminated from his employment at the "Daisy Dukes Company." The Department conceded that the taxpayer is not liable for the tax due for the month of September, 1992. Tr. p. 21; Dept. Ex. No. 1.
4. "David Dukes" began working for the "Daisy Dukes Company" in approximately 1979 as a salesman. Tr. pp. 39, 41. "Daisy Dukes" ("Daisy") is the taxpayer's grandmother. Tr. p. 40.
5. The "Daisy Dukes Company" was a retail store that sold appliances, furniture and electronics. Tr. p. 40. The company employed approximately 20 people. Tr. p. 40.
6. In approximately 1989, "David" became a vice-president of the company. Tr. p. 60. "David Dukes" was not a shareholder in the "Daisy Dukes Company." Tr. p. 40. ("David Dukes'" testimony)

7. "Daisy Dukes" was the president and shareholder throughout the audit period. Tr. pp. 60, 61. ("David Dukes'" testimony)
8. "Daisy Dukes", "Bo Dukes" and "Luke Dukes" were the directors of the company. Tr. p. 42. ("David Dukes'" testimony)
9. The company's outside accountant prepared the sales tax returns for the tax period and submitted them to the company's accounting department. Tr. pp. 48, 49. The company's accounting department prepared a payment check for the tax due. Tr. p. 49. The tax return and the check were placed on "David's" desk in the office that "Daisy" and "David" shared. Tr. pp. 49-51. ("David Dukes'" testimony)
10. "David Dukes" signed the sales tax returns for the months of April, May, June, and July of 1992. Taxpayer Ex. No. 1.
11. "David" knew that at times the sales tax returns were not immediately mailed, instead the tax returns sat on "Daisy Dukes'" desk. The mailing of the sales tax returns and the check was delayed until there was enough money in the company bank account to cover the sales tax payment. Tr. p. 124. ("David Dukes'" testimony)
12. An employee of the Illinois Department of Revenue visited the business in March of 1992 to close the business due to sales tax delinquencies. Tr. p. 53. During the tax period, "David" knew of the visit by the Department employee and the reasons for the visit. Tr. p. 53. ("David Dukes'" testimony)
13. The Department employee met with "Daisy" and "Daisy's" attorney. Tr. p. 54. Although "David" did not participate in the meeting, he was aware it took place.

Tr. pp. 54, 55. The Department did not close the business as a result of this meeting. Tr. p. 54. ("David Dukes" testimony)

14. After the Department employee's visit to the business, the office procedures governing the preparation of the tax returns and the accompanying checks were not changed. Tr. p. 55. ("David Dukes" testimony)
15. On or about October 19, 1992, "David" entered a hospital following a nervous breakdown. Tr. p. 57. On or around that time, "David Dukes" filed for bankruptcy. Tr. p. 58. ("David Dukes" testimony)
16. In the early 1990's, the company had financial difficulties and problems paying its bills. During the tax period, "David" was aware that some company checks had been returned by the bank because of insufficient funds. Tr. p. 81. On or around that time, "Daisy" asked "David" to terminate employees. Tr. pp. 79, 80. ("David Dukes" testimony)
17. During the tax period, had discussions with "Daisy Dukes" concerning the business's cash flow problems. Tr. p. 85. ("David Dukes" testimony)
18. During 1992, "David" was aware that the company was making payments for the Corvette he used. Tr. p. 87. ("David Dukes" testimony)
19. The Department also issued a Notice of Penalty Liability to "Daisy Dukes". "David" gave a deposition in that administrative hearings case sometime in October of 1996. Tr. p. 58.

CONCLUSIONS OF LAW:

The Department seeks to impose personal liability upon the taxpayer pursuant to

Section 452 ½ of the ROTA, which for the tax periods at issue, read in pertinent part as follows:

Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed in accordance with Section 3 of this Act and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. ...

Ill. Rev. Stat. 1991, ch. 120, ¶ 452 ½¹

The admission of the Notice of Penalty Liability issued herein into evidence establishes the Department's *prima facie* case. Branson v. Dept. of Revenue, 168 Ill.2d 247 (1995). In Branson, the Illinois Supreme Court held that the admission of the Notice of Penalty Liability into evidence established all of the statutory elements required for imposition of the penalty, including willfulness. Id. The burden then shifts to the taxpayer to overcome the presumption of liability, through sufficient evidence, that the person was either not a responsible officer or employee, or that his actions were not willful. Id.

In determining whether an individual is a responsible person the courts have indicated that the focus should be on whether that person has control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. *See e.g., Monday v. United States*, 421 F.2d 1210 (7th Cir. 1970), cert. denied 400 U.S. 821 (1970). Liability attaches to those with

¹ The Uniform Penalty and Interest Act, 35 ILCS 735/3-7, provides for a personal liability penalty for taxes incurred as of January 1, 1994.

the power and responsibility within the corporate structure for seeing that the taxes are remitted to the Government. Id. Responsibility is a matter of status, duty or authority, not knowledge of the tax liability. Mazo v. United States, 591 F. 2d 1151 (5th Cir. 1979). This duty to ensure that the taxes are paid stems from an individual's authority and power within a company to direct how a company conducts its financial affairs. Bowlen v. United States, 956 F.2d 723 (7th Cir. 1992); Purdy Co. of Ill. V. United States, 814 F.2d 1183 (7th Cir. 1987).²

"David Dukes" argues that he did not act as a responsible officer nor did he act willfully because "Daisy" was essentially in charge of the business and made the final decisions regarding the payment of creditors and the payment of the company's sales tax liabilities. Tr. p. 43. Although, the evidence at hearing suggests that "Daisy" was a responsible officer and in fact, "Daisy" withdrew her protest of the NPL issued to her, it is also apparent that "David" was sufficiently involved in the decisions concerning the preparation and payment of the sales tax liabilities that, as a result, he should also be held liable. The penalty may be imposed upon "[a]ny responsible officer ..."who it determines has willfully failed to act appropriately when discharging his tax reporting and/or paying responsibilities for the corporation. 35 **ILCS** 120/13.5 (formerly Ill. Rev. Stat. 1991, ch. 120, ¶ 452 ½) (emphasis added). The plain and clear text of the statute reflects that there may be more than one "responsible officer or employee" for a given corporation. Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366 1st Dist. 2000) (responsible officer penalty upheld against two brothers who were officers and

² The Illinois Supreme Court has analogized terms and phrases used in § 13½ of the ROTA with the judicial interpretations of similar terms and phrases used in federal "responsible person" tax penalty

employees of the same corporation); *see also*, Roth v. United States, 779 F.2d 1567, 1571 (11th Cir. 1986) (“There is no dispute ... that more than one person may be a ‘responsible person’ for an employer.”)

"David" cannot escape liability by arguing that he merely followed his grandmother's lead. "David" was a vice-president of the company and he was a signatory on the corporate bank account. "David" signed the corporate sales tax returns and the accompanying checks. Further, while "David Dukes" argues that he could not sign checks without "Daisy's" approval, (Tr. p. 46), there is no corroborating evidence that "Daisy" approved all checks written and, in fact, office procedures did not require "Daisy" to countersign checks.

As a result of the above, it is apparent that "David" did participate in the filing of sales tax returns as well as the payment of the sales taxes due. As a result, I find that "David" was a responsible officer of the company during the tax period.

It must also be determined whether taxpayer willfully failed to file and pay sales tax during the period in question. Although the pertinent statute fails to define willful conduct, Illinois courts have provided guidance for its determination beginning with Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill.2d 568 (1977). Willfulness is not merely limited to "intentional, knowing and voluntary acts." Monday, 421 F.2d at 1215. Willful conduct encompasses a reckless disregard for obvious or known risks. Id.

At hearing, "David Dukes" argued that he was not ultimately responsible for the payment of creditors and sales tax. There were several key areas of "David Dukes'" testimony at hearing, however, that directly contradicted his testimony given at the

statutes. Branson, 68 Ill. 2d at 261-62; Department of Revenue v. heartland Investments, 106 Ill. 2d 19, 29

October 16, 1996 deposition in the administrative hearings case, Department of Revenue v. "Daisy Dukes", 96 ST 0000. These contradictions involved "David's" level of participation in the company's remittance of sales tax. As a result, "David Dukes" testimony at hearing is not credible, and a finding that the taxpayer did not rebut the Department's *prima facie* case is warranted.

Specifically, taxpayer was asked the following question at hearing:

Q. "During the audit period in 1992, did there ever come a time when you decided not to send in sales tax returns along with a check because you were afraid the check would bounce?

A. Not to my knowledge, no."

Tr. p. 81, lines 9-14.

"David" also testified at the hearing that during the tax period, he assumed that "Daisy" filed the tax return and put it in the mail. Tr. p. 52, lines 10-13. "David's" responses at hearing directly contradict his testimony at the October 16, 1996 deposition (Tr. p. 86, line 6), wherein he testified that the sales tax remittance checks were not immediately mailed to the State after signature, instead they were deliberately held on "Daisy's" desk. At hearing, Department's counsel read the following excerpt from "David Dukes" deposition to show the contradiction:

"Question: We're on Page 87 now, Line 4: "So if you were the one signing the return, you were the one signing the check; if "Daisy" was the one signing the return, "Daisy" would be the one signing the check?

Answer: As I recall, yes.

Question: The check would be accompanying the return when it was placed on "Daisy's" desk or your desk; is that correct?

Answer: That is correct.

Question: And then it would be mailed out after that to the State?

(1977); Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill. 2d 568 (1968).

Answer: Not all the time.

Question: What happened and when?

Answer: Sometimes it would be held on the desk.

Question: Whose desk?

Answer: Usually "Daisy's"

Question: And give me a period of time that that would occur.
When did that start to occur?

Answer: Probably somewhere in early to mid '92.

Question: So early would be, like, January, February, March of
'92?

Answer: Somewhere in there, yes.

Question: Who made the decision not to send the check into the
State?

Answer: I guess it would have been me.

Question: Any why did you make that decision?

Answer: Based on the funds that were in the business, I did not want
the check to bounce."

Tr. p. 83, lines 2-24; Tr. p. 84, lines 1-16 (impeachment of "David Dukes" using
his testimony from October 16, 1996 deposition).

Later when questioned at the hearing in the instant matter, "David" could not recall
discussions with "Daisy" as to whether the sales tax returns and payments should be
mailed to the State or not. Tr. p. 85. This failure to recall is incredible given that at the
deposition he readily acknowledged having discussions with "Daisy" about "David's"
decision not to send the check into the State. Tr. p. 86, lines 2-24. "David" contradicted
himself once again when at hearing he maintained that he did not "review" the sales tax
returns, he merely handed them to "Daisy", (Tr. p. 77), whereat the deposition he
maintained that both he and "Daisy" reviewed the monthly tax returns. Tr. pp. 78, 79.

Taxpayer did not explain the reasons behind the contradictory testimony. "David" did point out, though, that he did not deal with the company's attorney or accountant and did not participate in meetings with the Department. Tr. p. 44. Further, on several occasions, he drove "Daisy Dukes" to the Department of Revenue to pay the sales tax due, (Tr. pp. 55, 56), and no events after the Department's visit to the business in March of 1992 led him to believe that the sales tax was not being paid. Tr. p. 56.

Taxpayer's arguments are not persuasive. While "Daisy Dukes" may well have reviewed the sales tax returns, this fact does not absolve "David Dukes" from liability, especially since "David" signed all but one of the sales tax returns during the tax period at issue. "David" had notice of the company's sales tax problems since he knew of the visit by the Department employee and the reasons behind the visit. At that point, "David" should have taken the necessary steps to ensure that the corporate sales tax payments were made. This responsibility was incumbent upon "David" as the corporate vice-president who signed the sales tax returns and the accompanying checks. Such an individual cannot escape liability simply because he hands the tax return and check over to his grandfather, another corporate officer. *See, Wright v. United States*, 809 F. 2d 425 (7th Cir. 1987), accord, *Calderone v. United States*, 799 F. 2d 254, 260 (6th Cir. 1986), quoting *Bolding v. United States*, 565 F.2d 663, 674 (1977) ("Thus, it cannot be that 'a responsible officer may immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for the nonpayment of [the corporation's] withholding taxes.'").

This determination is even further justified given that "David" had personal knowledge of the company's financial difficulties and that the sales tax returns and

checks were not immediately mailed but often sat on "Daisy's" desk because the company had insufficient funds at that time for payment. Taxpayer also admitted that during 1992, he knew that payments were made by the corporation for the Corvette he used. Tr. p. 87. Steps to follow up on the company's remittance of sales tax after his signature on the tax return were never taken by "David". Nor were adjustments made to the company's office procedures after the visit by Department personnel. Taxpayer, as a corporate officer and signatory, assumedly had access to the company's books and records. A review of these records would have revealed that the sales tax remittance checks had not yet cleared the corporate bank account.

"David" attempts to portray his grandfather as a controlling figure. While this may or may not be true, "David" was clearly an adult during the tax period and was the vice-president of the "Daisy Dukes Company". "David" willingly accepted the trappings of holding a corporate office in the family business, wherein he took on responsibilities related to the payment of Illinois sales tax. Certain responsibilities follow, including a responsibility to ensure that the company is remitting the appropriate sales tax to the State of Illinois.

Lastly, taxpayer argues that he could not have acted willfully during the tax period because of his poor mental health noting that he eventually suffered a nervous breakdown in October of 1992 and was hospitalized. In support of his argument, he presented the testimony of his psychiatrist, Dr. "John Doe", M.D. who first met and examined "David" in October of 1992, after the tax period in question.

When questioned, the doctor observed that "David" suffered from depression at the time of hospitalization in October of 1992, and most likely had suffered from this illness

months before. Upon hospitalization, the doctor completed an evaluation form wherein he concluded that "David's" "thought content and thought process is grossly within normal limits." Tr. p. 35. The doctor testified that this determination was based upon his conclusion that although depressed, taxpayer was not suffering from hallucinations, delusions, or psychotic thinking. Tr. p. 35.

Ultimately, Dr. "Doe's" testimony does not support taxpayer's arguments for several reasons. First, Dr. "Doe" did not examine "David" until October of 1992, therefore, he did not personally observe "David" throughout the tax period. At hearing, the doctor was asked the following question:

Q. Would his ["David's"] mental condition and the pressure he was under impair his judgment in any way?

A. Probably so based on parts of his history.

Tr. p. 28.

As evidenced by the Doctor's response quoted above, when specifically asked if "David's" depression impaired his judgment, the doctor could not be definitive. Further, the doctor never offered an opinion on whether "David" was capable of exercising good judgment specifically with respect to simple tasks such as paying corporate bills or taxes. What is clear, is that "David" was working and functioning at the business until he was terminated in October of 1992. As a result of the foregoing, I am unable to conclude that his depression was of such magnitude that he was unable to comprehend his own actions and that his decisions during the tax period should be set aside.

Secondly, even if I accepted "David's" contention, it does not explain why his deposition testimony contradicted his testimony at hearing, since both events took place well after the tax period and taxpayer's subsequent hospitalization.

Wherefore, for the reasons stated above, it is my recommendation that the Notice of Penalty Liability be finalized.

Date: May 23, 2001

Christine O'Donoghue
Administrative Law Judge